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The Most-Favoured-Nation Treatment Obligation: Trends Leading to its Marginalisation and whether a Threat to the Multilateral Trading System

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ABSTRACT

The Most-Favoured- Treatment Obligation is a fundamental principle under the multilateral trading system of the World Trade Organisation. The principle requires Members to accord the same tariff and regulatory treatment given to the product of any one Member at the time of import or export of “like products” to all other Members. However, recent trends show deviation from this rule so much so that it is most often applied as an exception rather than as a general rule. This paper examines the MFN Treatment Obligation, trends leading to the importance of its marginalisation and whether with the recent retreat its marginalisation is a threat to the multilateral trading system or merely an evolutionary step on the path to greater trade liberalisation.

I. INTRODUCTION

A necessity for the proper functioning of any organisation is the institution of basic rules for compliance by its members. The World Trade Organisation being an International organisation governing trade is not an exception to this rule. In compliance to this necessity, the World Trade Organisation has instituted basic principles for adherence by its Members in order to ensure the proper functioning of the multilateral trading system it represents. Under the WTO, however, five basic rules and principles² can be distinguished:

- The principles of non-discrimination;
- The rule on market access, including rules on transparency
- The rules on unfair trade;
- The rules between trade liberalisation and other societal values and interests; including the rules on special and differential treatment ;and
- The rules promoting harmonisation in specific fields

For the purposes of this discussion, only one arm of the non-discrimination principle³ namely, the Most-Favoured-National treatment obligation as it applies to goods and services will be discussed.

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² Peter Van Den Bossche, 'The law and Policy of the World Trade Organisation, Text, Cases and Materials', 2nd edition

³The other arm of the principle is that of National Treatment Obligation

The discussion will begin with a brief introduction of the MFN treatment obligation under the WTO as it applies to goods and services. It will then move to discussing some of the traditional exceptions to this MFN principle. The strict application of a law or principle in all circumstances will lead to injustice in society. To meet the need of justice therefore, the application of a law or principle will need flexibility as facts and circumstances to which it applies differ. This will therefore call for exceptions to the prescribed standard just as there are exceptions to the MFN treatment obligation⁴ under the WTO law. After discussing some of these exceptions, the discussion will then look at the recent trends leading to the importance of the MFN principle being marginalised over the last two to three decades so much so that it is now most often applied as an exception rather than a general rule and whether the recent retreat or marginalisation is a threat to the multilateral trading system. The discussion will end with a conclusion with regard to the recent retreat from the MFN treatment obligation.

II. BASIC PRINCIPLE OF MFN TREATMENT OBLIGATION

This principle of Most-Favoured-Nation treatment obligation is found in Article I of the General Agreement on Tariffs and Trade (GATT) 1994 with regard to goods and Article II of General Agreement on Trade in Services (GATS) with regards to service.

Article I of the GATT 1994 states:

“With respect to custom duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the International transfer of payment for imports or exportation or imposed on the International transfer of payments for imports or export, and with respect to the method levying such duties and charges, and with respect to all matters referred to in paragraph 2 and 4 of Article III, any advantage, favour or immunity granted by any contracting party to any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like products originating in or destined for the territories of all other contracting parties.”

Article II of GATS which deals with the principle of MFN as it applies to services states:

⁴ There is the fear that this might lead to the weakening of the multilateral trading system

“With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers.”

The MFN principle as it applies to goods and services requires a WTO Member which grants any favourable treatment to any Member to grant that same favourable treatment to all other WTO Members⁵. A WTO Member is not allowed to discriminate between its trading partners under this rule by, for example, giving products imported from one contracting party more favourable treatment with respect to market access than the treatment it accords to products from other Members.

The MFN treatment obligation requires any advantage granted by a WTO Member to imports from any country to be granted immediately and unconditionally to imports from all other WTO Members⁶. Once a Member has granted an advantage to one Member, it cannot make the granting of that advantage to other Members conditional upon those other Members giving something in return or paying for the advantage. The granting of an advantage under this rule must not be conditional on whether a Member has certain characteristics, certain legislation in place or undertakes certain actions⁷.

The advantage which is supposed to be given immediately and unconditionally to all other WTO Members can only be accorded to like products, services and service suppliers. Unlike products, services and service suppliers may be treated differently. In determining likeness of products, the panel in Spain-Unroasted Coffee took into consideration the characteristics of the products, their end-use and tariff regime of the other Members. In effect the fundamental principle behind the MFN treatment obligation is the prevention of discrimination amongst WTO Members with regard to like products, services and service suppliers.

III. EXCEPTIONS TO THE MFN PRINCIPLES AS IT APPLIES TO GOODS AND SERVICES.

As earlier said the strict application of any rule in all situations will lead to injustice as situations differ. Thus, there are always exceptions to rules just as there are exceptions to the MFN principle. The exceptions to this MFN principle should, however, not be applied in a manner which would

⁵ Peter Van Den Bossche, ‘The Law and Policy of the World Trade Organisation: Text, Cases and Materials, ‘2nd edition

⁶ This equally applies to exports

⁷ Panel Decision in Belgium-Family Allowances

constitute arbitrary or unjustifiable discrimination or disguised restriction on trade. Common exceptions to the MFN rule as it applies to goods and services are found in Article XXIV of the GATT 1994 and Article XIV of GATS which are:

- Necessary to protect public morals or maintain public order ;
- Necessary to protect human, animal or plant life and health;
- Necessary to secure compliance with laws not consistent with the agreement including, example fraud, privacy and safety.

All these exceptions are entitled 'general exceptions' both on the GATT 1994 and GATS. These exceptions allow a member to adopt measures or legislations necessary to protect and promote the above societal values and interests. There are however exceptions to the MFN treatment obligation under the GATS wherein exemptions listed by WTO Members are highly recognised. 424 exceptions are listed by 79 Members:

- 18 OECD with 157 exemptions
- 61 non –OECD with 267 exceptions
- Of the 49 members with no exemption, 48 are non OECD

Half of all exceptions are transport and audio-visual and one third are financial services. There is however other provisions which permit deviation from this MFN treatment. Like GATT Article XXIV which allows Members to afford more preferential treatment to countries with which they have entered into a free trade agreement or custom union in the case of merchandise trade. GATS Article V also allows for regional integration with exemption of countries participating in integration agreement from the MFN requirements. Article V permits a WTO Member to enter into an agreement to further liberalise trade in services on a bilateral or plurilateral basis, provided the agreement has 'substantial sectorial coverage' and removes substantially all discrimination between participants. It therefore means that discrimination is not permissible between Members of a trade zone or custom union but different conditions may be applied to Members of the WTO which are not members of a particular trade zone or custom union. This is clearly a deviation from the MFN rule which requires same immediate and unconditional treatment to all WTO Members. While Economic Integration Agreements must be designed to facilitate trade amongst participants, Article V of GATS requires that the overall level of barriers is not raised vi-a-vis non participants in the sectors covered. Otherwise should an agreement lead to the withdrawal of commitments, appropriate compensation must be negotiated with the Members affected. Such situations may arise, for example, if the new common regime is modelled on the previous regime of a more restrictive trade. Though participants to a trade agreement are prevented from

discrimination, there is however deviation from the MFN rule as different conditions may be applicable to other WTO Members out of the particular trade agreement.

Another exception to the MFN principle worth discussing is that in the Enabling Clause to the GATT 1994 which allows for preferential market treatment to developing countries. The equivalent provision in the GATS is Article IV which talks of special priority for Less Developed Countries.

The Enabling Clause in practice gives permanent validity to the Generalised System of Preference (GSP). It permits developed countries to discriminate between different categories of trading partners (in particular, between developed, developing and least developed countries) which would otherwise violate Article I of the GATT 1994 which requires no WTO Member to be treated worse off than any other (MFN treatment). In effect, this allows developed countries to give preferential treatment to poorer countries, particularly to least developed countries. Developing countries are permitted to enter into preferential trade agreements which do not meet the strict criteria laid out in GATT 1994. There is the need for flexibility in situation of developing countries being part to trade agreements⁸. This is a violation of the MFN treatment under the WTO law. Giving preferential treatment to developing countries means that other WTO Members particularly the developed countries will be treated worse off than these developing countries whereas the MFN treatment requires equal treatment to all WTO Members with regard to trade in goods and services,

Another exception worth discussing is the security exception in Article XXI GATT 1994 and Article XIV bis of GATS. This exception gives Members freedom to take any measure necessary in the interest of their national security. It allows WTO Members to take trade restrictive measures as a means to achieve national security⁹. Under this exception, Members can, subject to limitations, provide protection through import tariffs, production subsidies and government procurement practices. It permits a Member to adopt or maintain certain measures which that Member considers necessary for its essential security interest. Members have very wide ambit under this exception with regard to measures to adopt to protect security. However, it is imperative that a certain degree of judicial review be maintained otherwise the provision will be prone to abuse without redress. At a minimum, Panel and the Appellate body should conduct an examination as to whether the explanation presented by a Member with regard to its security measures constitute an apparent abuse¹⁰. This security exception thereof undermines the WTO principle of MFN

⁸ World Trade Organisation, 'The General Agreement on Trade in Services: An Introduction', March 2006

⁹ Article XXI of GATT was invoked as a defence in US-Export Restriction (1949), *Oslavia*

¹⁰ The GATT US-Imports of sugar from Nicaragua(1984), *ECC-Trade Measures taken against Social Republic of Yug.* Panel's statement in *US-Trade Measures Affecting Nicaragua*

treatment. For the purpose of security Members may adopt trade barriers and preferential treatment in their trade dealings. Any form of preferential treatment for the purpose of security will be violation of the MFN treatment.

IV. TRENDS LEADING TO THE IMPORTANCE OF MFN MARGINALISATION

Though the MFN treatment is one of the fundamental principles of the multilateral trading system under the WTO, recent trends show a deviation or retreat from this principle such that it is now most often applied as an exception rather than a general rule.

The need to protect other societal values and interests which might not be of economic benefits has led to the importance of the MFN treatment obligation being steadily marginalised over the last two to three decades. The promotion and protection of public health, consumer safety, the environment, employment, economic development and national security are core tasks of government. It is true that through trade environmentally friendly products or life-saving medicines that would not be available otherwise becomes available to consumer and patients respectively. But to protect and promote these societal values and interests, governments also frequently adopt legislations or measures which inadvertently or deliberately constitute barriers to trade.

To promote and protect these societal values and interest, Members are often politically and/or economically compelled to adopt measures or legislations which are inconsistent with principles of the WTO law especially the principles of non-discrimination¹¹ and the rules on market access. The ever increasing demand for the protection of these societal values and interests which might not be of any economic benefits but very important to the Members accounts for the marginalisation of the MFN over the last two or three decades.

The need to increase participation of least and developing countries in International trade is an important contribution to MFN marginalisation. There are often complaints by least developing countries about their little involvement in International trade. To increase the participation of least and developing Members, the WTO law permits Members to provide preferential market access to least and developing countries. A strict application of market access conditions amongst the developed, least developed and developing Members will discourage the participation of the least and developing Members as they are often poor to compete with the developed Members. One way to increase the participation of these poor countries in International trade is to provide them

¹¹ Particularly the principle of MFN treatment obligation

with preferential market access condition which is contrary to the WTO principle of non-discrimination (MFN). Though this violates WTO law it is necessary given the increased contribution by the developing countries to International trade. This justifies marginalisation of the principle of MFN treatment.

The increase in trade liberalisation through bilateral and plurilateral agreements is a cause to the marginalisation of the MFN principle. Article XXIV of the GATT 1994 and Article V of GATS allow liberalisation through regional integration such as custom unions and free trade zones. The ever increasing number of trade zones is an important contribution to the marginalisation of the MFN principle.¹² Members of free trade zones and custom unions are permitted to apply conditions different to the ones applicable to non-Members of the free trade zone or custom union. This violates the MFN principle which requires equal treatment for all. This integration agreement which allows subsets of the WTO to liberalise trade amongst themselves, does not however permit them to go against the multilateral trading system. Members to a trade zone or custom union are not allowed to discriminate against non-Members, for example, taxing out of the prescribed limits. In so far as the difference in taxing is within limits it is acceptable. Members to a trade zone or custom union will normally have a common interest. To achieve that common interest is to allow them to determine how to trade amongst themselves provided it is in accordance with the multilateral trading system. To protect that common interest is a ground for marginalisation of MFN principle. Equal treatment might not achieve that common interest of a trade or custom union.

V. RETREAT A THREAT TO THE MULTILATERAL TRADING SYSTEM?

There is much debate on this retreat from MFN principle. While others consider it dangerous to the multilateral trading system others are optimistic about it. The fear is that abandonment of multilateral liberalisation in favour of bilateralism and regionalism could, in the longer term, erode the rules and disciplines underpinning the WTO. As its Members' political commitment weakens, so too could their willingness to respect its dispute settlement proceedings, the bedrock of its authority.¹³ Pascal Lamy, Director General of WTO has an optimistic view about this recent retreat from MFN treatment.¹⁴

¹² By July 2005, only one WTO Member-Mongolia was not part of a regional trade agreement.

¹³ G.de Jonquieres, 'Global Trade: Outlook for Agreement Nears Moment of Truth,' Financial Times, 24 January 2006

¹⁴ COMESA and SADC have contributed to a better preparation of their member countries on trade issues, which had positive spill overs on their participation in the WTO

In my opinion this retreat from MFN is not a fundamental threat to the multilateral trading system but merely an evolutionary step on the path to greater trade liberation.

Regional trade agreements can actually support the WTO multilateral trading system. Regional groupings can play a much needed role in the WTO preparations by raising awareness, by training, by providing a platform for the exchange of views and information, and by stimulating trade capacity building initiatives which can increase the participation of their Members in the WTO¹⁵. Regional agreement has allowed groupings of countries to negotiate rules and commitments that go beyond what was possible at the time multilaterally. In turn, some of these rules have paved the way for agreements in the WTO. Services, intellectual property, environmental standard, investments and competition policies were all issues that were raised in regional negotiations and later developed into agreement or topics of discussion in the WTO. In effect regionalism is an evolutionary step on the path to greater trade liberalisation as it complements the multilateral trading system and not a threat to it. This is much seen in the view that commitments within the regional groupings to achieve a common interest could enhance negotiations in the WTO. Ideas not initially thought of might be brought in by these regional groups and such ideas will contribute to the development of WTO principles. A law or rule is only necessary to meet the needs of the society and changes in society should therefore modify the application of a law or principle to make it in touch with the contemporary society.

VI. CONCLUSION

The Most-Favoured-Nation treatment obligation, although it is subject to a number of exceptions and recent trends show retreat from it such that it is now most often applied as an exception rather than a general rule still stands as one of the fundamental pillars of the WTO. Subject to the exceptions, MFN treatment remains a principal obligation for WTO Members. Members will always be expected to adhere to the obligation in the absence of the exceptions to the rule. Its marginalisation should therefore not be considered a threat to the multilateral trading system under the WTO but a necessary evolutionary step on the path of greater trade liberalisation.